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Whiteside & Associates

Transportation & Marketing Consultants

May 15, 2000

Office of the Secretary
Surface Transportation Board
Case Control Unit
1925 K Street, NW
Washington, DC 20423-0001

Attn: Ex Parte No. 582 Sub No. 1: Major Rail Consolidation Procedures

Dear Mr. Secretary:

Pursuant to the Decision of the Board on March 31, 2000 in the above-described proceeding, please find enclosed the original and twenty-five copies of the Statement of Montana Wheat & Barley Committee, Colorado Wheat Administrative Committee, Idaho Barley Commission, Idaho Wheat Commission, Oregon Grains Commission, Nebraska Wheat Board, South Dakota Wheat Commission, and Washington Barley Commission referred to as the Wheat, Barley and Grains Commissions.

Also please find enclosed an IBM compatible floppy diskette electronic copy of the enclosed statement.

Please receipt duplicate copy and return in the self-addressed stamped envelope for our records.

Respectfully submitted,

Terry C. Whiteside
Registered Practitioner representing
Montana Wheat & Barley Committee, Colorado Wheat Administrative Committee, Idaho Barley Commission, Idaho Wheat Commission, Oregon Grains Commission, Nebraska Wheat Board, South Dakota Wheat Commission, and Washington Barley Commission

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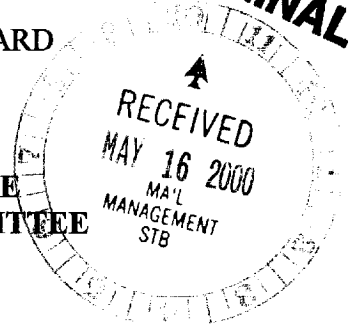

BEFORE THE SURFACE TRANSPORTATION BOARD

STATEMENT
of
MONTANA WHEAT & BARLEY COMMITTEE
COLORADO WHEAT ADMINISTRATIVE COMMITTEE
IDAHO BARLEY COMMISSION
IDAHO WHEAT COMMISSION
OREGON GRAINS COMMISSION
NEBRASKA WHEAT BOARD
SOUTH DAKOTA WHEAT COMMISSION
WASHINGTON BARLEY COMMISSION

STB Ex Parte No. 582 (Sub-1)
Major Rail Consolidation Procedures
May 16, 2000

The above listed parties, referred to as the Wheat, Barley & Grains Commissions, herewith submit their joint comments in the above-styled proceeding.

BACKGROUND

The Wheat, Barley & Grains Commissions thank the Board for holding this rule-making proceeding and hope the Board will look at the problems of rail consolidations and the market dominance created by past merger policy procedures as they develop future rail consolidation procedures. However, the Wheat, Barley & Grains Commissions are concerned that this proceeding will not focus on the larger issue of rail-to-rail competition, or lack thereof, in the nation's railroad industry. This lack of railroad competition today has come about due to the effects of past merger policy interpretations.

WHAT IS THE UNITED STATES RAIL POLICY ON COMPETITION?

The Railroad transportation policy outlined in the ICC Termination Act clearly states "In regulating the railroad industry, it is the policy of the United States Government –

> " (1) to allow, to the maximum extent possible, competition and the demand for services to establish reasonable rates for transportation by rail;...
> "(3) to promote a safe and efficient rail transportation system by allowing rail carriers to earn adequate revenues as determined by the Board;
> "(4) to ensure the development and continuation of a sound rail transportation system with effective competition among rail carriers and with other modes, to meet the needs of the public and national defense;..."[1]

The General Accounting Office (GAO) focused on this in their report RCED-99-46 issued in February 1999, on competitive access issues:

[1] §49 USC 10101. Rail Transportation Policy

- 75% of shippers surveyed believe they are being overcharged with unreasonable rates
- 70% of shippers believe that the time, complexity and cost of filing complaints are barriers
- 81% of shippers want STB to grant trackage rights to other railroads
- 75% of shippers want STB to increase access for shortlines and/or regional railroads
- 74% of shippers want STB to grant reciprocal switching upon reasonable request
- 71% want railroads to be required to quote rates on all segments of their system
- 49% want shippers to have right to route their own shipments

The merger policies of the past have brought us to the unparalleled railroad market concentration that has not been experienced by this country for about 100 years.

The problem with the current railroad merger policy is:

1. Past merger policies have not considered it against the public interest to allow railroad carriers to become completely dominant in large geographic areas.
2. Past merger policies have not developed a standard that mandated a minimum number of carriers serve each rail customer.
3. Past merger policies have not considered actions by other federal regulatory agencies, such as the FCC and the FERC that have fostered competition in other network industries, resulting in thriving industries.

Under current rail merger policy, when is concentration too much? When there are only two railroads? In the western U.S. we already have only two major monopoly railroad systems! Shortly there will be a nationwide two major monopoly railroad system. Will it then be time to reintroduce competitive balance into the system? Can competition be introduced without regulatory promotion?

The Wheat, Barley & Grains Commissions are all from states that have large areas with no rail-to-rail competition. Has this always been the case? The answer is no. In Montana, Idaho, and Washington, for example, in 1970 there were 4 Class I railroads serving the region. When the ICC allowed the Northern lines merger to combine three of the four Class I railroads and left the weakest of the four to be the designated "competitor," it set in place the total monopolization of the rail industry in those states. Seven years after the merger, the "designated competitor" declared bankruptcy, and the entire region was left with a single monopoly rail carrier. The Commission never looked back on this failed merger policy or sought to reintroduce competition. Thousands of rail customers from the Mississippi River to the Pacific Northwest Coast have lost competitive rail service. This failing has occurred over and over again in the west. The ICC/STB seems to pretend that these instances of lost competition do not exist by assuming, in future mergers, that all of these captive rail customers' areas do not have rail competition today, therefore the Board is not obligated to introduce it in the future. Similar losses of competitive service have occurred in Colorado, Nebraska, Oregon and South Dakota due to mergers approved by rail regulators. Yet the lack of rail competition was created, in many cases, by failed railroad merger policy carried out by the ICC/STB in the past.

The result: Virtually the whole western U.S. farm belt is captive. Farmers are paying the highest freight rates in the country, and their service levels continue to deteriorate. The freight

rates paid as a percentage of the value of their commodities has risen from around 10% in the late 1970's to over 50% in some of the markets. They pay the highest freight rates in North America because they have lost competitive rail. The railroads claim their rates have fallen, yet do not account for the shift of rail costs to the rail customers. Rail customers are required, in many industries, to own cars, invest in their own fast loading facilities and then required haul by truck to ever more distant terminals. These factors are not accounted for in the railroads statement that rates have fallen. In summary, farm producers now face the highest total freight costs ever, elimination of competitive rail, service levels deteriorating, shift to highways that have proven devastating to highway infrastructure, and a regulatory scheme that won't protect them from rates as high as 300+% of variable cost.

WHAT IS NEEDED IN COMPREHENSIVE RAIL POLICY?

What is needed is a comprehensive rail policy that promotes, indeed requires, competition among the nation's railroad industries. Guided by its regulators such as the FCC and FERC, every other formerly monopoly dominated, network industry has been successfully transformed into self-reliant, competitive and vibrant industries.

The history of major rail consolidation procedures is one that has been characterized by both commonality to the past and change to meet the current needs by rail customers and rail industry in regulatory policy. It is time to change regulatory merger policy again because many competitors no longer characterize the underlying rail infrastructure. Today, the industry is characterized by a system of four major rail systems with two controlling the East and two controlling the West. Further, leaders in the rail industry indicate that they intend to continue merging, and it is clear that we could soon see only two transcontinental railroads controlling all of North America's rail freight.

There were three distinct periods in major rail consolidations. The Transportation Act, 1920 returned the railroad system to private ownership after the World War I nationalization. Congress was desirous of massive railroad consolidation in order to produce a limited number of financially viable carriers which would be able to produce a uniformly high level of service for the shipping public. The Commission was therefore ordered to prepare a general plan of consolidation for all continental United States railroads. There were to be a limited number of systems and the final plan required that each carrier have approximately the same earnings ability so that uniform rail rates would be feasible. In addition, the 1920 Act mandated that when grouping the railroads, "competition shall be preserved as fully as possible and whenever practicable the existing routes and channels of trade and commerce shall be maintained".[2]

In February 1925, the Commission sent a letter to the chairman of the Senate Committee on Interstate and Foreign Commerce which stated that, "the majority of the Commission expressed doubt as to the wisdom of the provisions of the law which now requires us to adopt a complete plan to which all future consolidations must conform".[3] The ICC went on to request

[2] As quoted in Emory R. Johnson, Government Regulation of Transportation (New York: D. Appleton-Century Co., 1938), p. 318.
[3] Emory R. Johnson, pp. 320-321.

that Section 5 be amended to eliminate the "master plan" concept and instead the Commission would authorize all mergers which were found to be in the public interest.

The Transportation Act of 1940 amended Section 5(2) of the Interstate Commerce Act by stating that the ICC may authorize rail mergers if they are found to be "consistent with the public interest." Also, the Commission may impose "just and reasonable" conditions on the applicants. The "master-plan" concept, however, was completely abandoned in favor of a case-by-case approach.

The 1940 Act did contain four specific aspects that the ICC must consider as part of the "public interest." Section 5(2) (c) enumerates them as follows: (1) the effect of the proposed transaction upon adequate transportation service to the public; (2) the effect upon the public interest of the inclusion, or failure to include, other railroads in the territory involved in the proposed transaction; (3) the total fixed charges resulting from the proposed transaction; and (4) the interest of the carrier employees affected.

By enacting the Transportation Act of 1940, Congress finally removed the totally unworkable 1920 Congressional mandate that all railroad mergers must comply with the ICC "master plan." Instead, the ICC was given the power, under Section 5(2) of the Interstate Commerce Act, to authorize railway merger cases on an individual basis as long as they are found to be "in the public interest."

When Congress passed the Staggers Rail Act in 1980 relaxing regulatory oversight, the idea and basic premise was that competition between the forty (40+) plus Class I railroads would provide the surrogate for stricter regulation. The ICC was encouraged to rely on market competition to guard against market abuse. This supposed competition among the nation's railroads would provide service and price competition preventing predatory pricing and market dominance by single railroads. There was recognition, by most parties, the nation's railroads needed to rationalize some of its branch line systems, and the regulatory oversight was streamlined to allow speedier abandonment procedures.

- Congress never envisioned that the forty (40+) plus Class I railroads would, after some 50+ mergers become 4 dominant carriers – 2 in the eastern half and 2 in the western half of the United States. These carriers are preparing to merge further into a transcontinental two-monopoly system, but it should be apparent that the rail customers in this country are already faced with the negative by-products of a two-monopoly and in many cases, a single monopoly rail system. Today, four U.S. mega carriers generate 95% of the gross ton-miles and 94% of the revenues in the U.S. The two U.S. western rail major carriers generate 92% of the gross ton-miles and 90% of the revenue in the west.
- It was never envisioned by Congress that the railroads would be allowed to continuously merge and eliminate, over large portions of the country, the rail-to-rail competition that was supposed to protect rail customers from monopoly abuse.
- It was never envisioned in 1980 by Congress that the railroads would become so dominant that an ***entire state*** would be dominated by a single monopoly railroad.
- Congress never envisioned that the railroads would become so dominant that ***entire industries*** would be dominated by a single monopoly railroad.

- Congress never envisioned that the railroads would become so dominant that ***entire sections*** of the country would be dominated by a single monopoly railroad.

The result of the ICC/STB rail merger policy has been to allow not just plant rationalization as envisioned by the ICC/STB but competitive and capacity rationalization as well.

How did this happen? The regulatory policy adopted by the ICC and reaffirmed by the STB considered that the 'public interest' of developing financially strong railroads was more important than the 'public interest' requirement that all rail customers, by requiring service by multiple railroads, be protected from monopoly abuse. The nation's railroads have convinced regulators that large monopoly railroad systems are more financially viable and more consumer responsive than a railroad industry characterized by intra-modal competition. Thus competition among rail carriers was not considered as important as the other goals of plant rationalization, revenue adequacy, and claims by the merger partners of improve service. In short, 'public interest', as interpreted by the ICC/STB, has not included rail-to-rail competition important enough to protect the rail customers from market and service abuse by evermore dominant railroad monopoly or important enough to curtail the loss of rail-to-rail competition.

Now the nation's rail customers in commerce, nationally and internationally, are paying the price of monopoly concentration.

The history of merger regulation reflects a living policy that has been revised and overhauled when the circumstances and infrastructure required changes. Today, this country is faced with more concentration of railroad monopoly power than has existed for over 100 years.

DISCUSSION:

A. Plant rationalization: Since 1970, the nation's railroads have abandoned nearly half of their track, including thousands of miles of branch and mainline. In the western states, this effectively caused a massive shift to less traveled highways and higher cost transportation to more distant rail points and resulted in effectively shifting the cost of transportation for large portions of the west from the private sector (railroads) to the public sector (state, local and county governments). While merger policy was intended to rationalize an overbuilt physical plant, it certainly should not have sanctioned the development of a capacity-constrained rail system in an era of rapid freight growth. The rail industry today is hauling virtually the same tonnage they were hauling 40 years ago, and yet freight traffic has grown exponentially in this country. Regulators allowed railroads, under the guise of striving for increased efficiency, to eliminate gateways and close many joint routes. They allowed the nation's carriers to establish more and more steel barriers to rail competition. They allowed carriers sell off branch lines and create paper barriers to stifle interstate rail competition. All of these decisions further reduced competitive options for this nation. The 'public interest' of the railroads was chosen to be more important than the 'public interest' of the rail customers.

B. Establishment of Bottlenecks: Under the guise of plant rationalization and as the railroads became more and more dominant, they chose, through transportation pricing, to close many gateways that had existed for many years. Regulators allowed this successive closing

when told by the dominant carrier that this would lead to greater efficiency. The effect was to further eliminate competition. Then in an amazing turnabout, the regulators defended the carriers action in closing off bottlenecks by stating the carriers would lose revenues if they opened them back up! Again the 'public interest' of the railroads was chosen to be more important than the 'public interest' of the rail customers.

C. Eliminating Rail-to-Rail Competition is Later Sanctioned as the Norm: If a rail merger in the past failed to deliver the benefits of competition and led to ultimate elimination of competition, then the regulators have chosen to accept that fact as the norm for all future rail mergers. It can be argued that the widespread railroad bankruptcies of the 1970's were, in fact, the result of the railroad merger's spoils of the 1960's and 1970's and not due exclusively to excessive regulatory oversight.

Regulators have further adopted the philosophy that the only time to act to maintain rail-to-rail competition is when a rail customer is facing a rail merger going from two to only one railroad. Representatives of the wheat and barley industry have heard duopoly railroads say they will not compete with the other railroad in the area, because they do not want to upset the other carrier in this region of the country. The dominant carriers have chosen overtly to not allow development of value-added plants that would process farm commodities within their franchises, as they demand to haul the farm commodities to market or export positions.

The Wheat, Barley & Grains Commissions feel that a strong argument can be made that the minimum number of rail carriers to establish truly competitive service to all rail customers should be three equally strong carriers. The presence of only two equally strong rail carriers in a region many times leads only to efficient collusion.

Competition in other network industries has lead to introduction of new technology, increased investment to protect market share resulting in lower costs and higher profits while providing better service.

RECOMMENDATIONS:

The Wheat, Barley & Grains Commissions recognize that the Board is at a crossroads and is recognizing rail-to-rail consolidations are at an end. Rail consolidations have reached a peak. Further elimination of rail competition for rail customers is not in the 'public interest.' Today, we have as much concentration in the rail industry as existed in 1887 when the Act to Regulate Commerce came into effect.

1. The Board should adopt a merger policy that does not allow any further lessening of rail-to-rail competition.

2. The Board should adopt a merger policy that in all future rail mergers, all rail customers should have the right to rail-to-rail competition as a matter of national rail policy and for those rail customers that do not have rail-to-rail competition, this Board should adopt a responsible regulatory relief system.

3. The Board should adopt a pro-competitive stance in every action and decision.

4. If the Board does not feel it has the authority to act in a pro-competitive stance it should immediately seek such authority. The ICC, the STB's predecessor consistently and yearly made requests to Congress of its legislative recommendations. Other Federal Administrative agencies such the FCC, FERC, FRA and DOT regularly make requests to Congress for specific legislation to cover ever-changing industrial climate.

5. The Board should work with captive rail customers to develop realistic, reasonable, and fair protection methods for small captive rail customers that today have no competitive rail choice.

6. The key merger criterion for measuring adverse effects should be the effect of all future rail mergers on rail customers who pay the freight bills. Without rail customers, railroads don't exist. The goal of future regulatory oversight thus will be to prevent future competition-lessening rail mergers.

7. Preserving and fostering rail competition should be the preferred solution over regulatory oversight. However, in areas where rail competition is not possible, reasonable regulatory oversight must be economically available to rail captive customers.

8. Economic regulation and competition are both parts of the whole and must be promulgated to have the effect of providing rail customers with adequate service and reasonable rates.

9. Rail mergers should be re-opened in the event rail competition is curtailed or lost, and the regulator should condition all rail mergers to enhance, not just maintain, competition in the future. Options such as competitive access, bottleneck pricing, terminal access, reciprocal switching, joint running rights, elimination of paper and steel barriers and arbitration to maintain competition must be available to mitigate anti-competitive effects of mergers. In past railroad mergers, the Board has 'monitored' post merger performance rather than becoming pro-active by taking more significant corrective measures to correct loss of merger benefits. In short, the Board needs to become more aggressive on behalf of preserving and promoting competitive options.

10. Railroads should be held accountable financially for service failures emanating from a merger and customers should be compensated for economic losses suffered by customer as a result of service diminishments.

11. The Board should support S. 621 and H.R. 2784 or H.R. 3446 as ways to increase competition in the railroad industry without increasing regulation. In the alternative, the Board should take a pro-active stance on competition and forward its own legislation to promote competition among the remaining railroads.

12. The Board should require pricing over bottlenecks, open access in terminal areas, mandate reciprocal switching and develop surrogates for competition for those captive rail customers that have been left without rail-to-rail competition.

The maintenance and enhancement of rail-to-rail competition is critical to survival of the 100,000 agricultural producers in the states represented by the Wheat, Barley & Grains Commissions. There is not a more critical transportation issue for the long-term survival of these producers.

Submitted by:

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5/12/2000
Date:

For:
MONTANA WHEAT & BARLEY COMMITTEE
COLORADO WHEAT ADMINISTRATIVE COMMITTEE
IDAHO BARLEY COMMISSION
IDAHO WHEAT COMMISSION
OREGON GRAINS COMMISSION
NEBRASKA WHEAT BOARD
SOUTH DAKOTA WHEAT COMMISSION
WASHINGTON BARLEY COMMISSION

CERTIFICATE OF SERVICE

I hereby certify that the above described Comments of the Wheat, Barley & Grains Commissions has been duly served on all Party of Record identified on service list via first class mail in the United States Postal Service this 15th day of May, in the USPS station in Billings, Montana 59101.

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